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Before The
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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In the Matter of	)	
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Implementation of Sections of the	)	
Cable Television Consumer Protection	)	MM Docket No. 92-266
and Competition Act of 1992:	)	
	)	
Leased Commercial Access	)	CS Docket No. 96-60

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REPLY COMMENTS OF ENCORE MEDIA CORPORATION

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SUMMARY

The record in this proceeding conclusively establishes that the Commission's proposed valuation formula would result in leased access charges of little or nothing for most programming services on regulated tiers. This counter-intuitive result underscores the critical importance of including some measure of a channel's impact on subscriber demand in valuing channel capacity. Data from several subscriber surveys confirm that subscribers would not accept typical leased access channels as full-value replacements for existing programming services. Instead, the widespread deletion of programming caused by subsidized leased access pricing would result in nearly universal subscriber dissatisfaction and significant losses of subscribers. These projected subscriber losses would have a substantial and quantifiable adverse impact on cable operator revenues which must be reflected in the value of channel capacity.

Because cable operators would delete the most recently launched programming services to accommodate subsidized leased access demand, the deleted channels would not have reached their full revenue-generating potential. Such channels simply would not have had a sufficient opportunity to build subscribership and viewership through extended promotion. Consequently, the Commission's channel-by-channel valuation approach, which is limited to averaging the lost revenues directly associated with such channels, further understates the value of leased access channels.

Although they clearly do not address the fundamental problems in the Commission's proposal, workable and equitable transition rules are needed to mitigate a disruption and injury to programmers and subscribers resulting from any substantial change in

the leased access rules. Cable programmers must incur programming licensing commitments and costs years in advance. Whether the Commission adopts a multi-year transition period (as suggested by Encore), a "grandfathering" approach for existing services, a bifurcated rate formula for vacant channels versus channels requiring deletions, or some other transition alternative or combination of alternatives, the Commission must take action to prevent massive disruption to subscribers and programmers and significant decreases in programming diversity. The Commission also should not require cable operators to delete existing programming services in order to accommodate part-time leased access carriage, which would unnecessarily decrease programming diversity. Finally, if the Commission requires cable operators to designate prospective deletions, it should authorize flexible redesignations to enable programmers to negotiate for continued carriage. However, reconsideration of the fundamental premises of the Commission's proposal remains the only real answer

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REPLY COMMENTS OF ENCORE MEDIA CORPORATION

Encore Media Corporation ("Encore") submits these reply comments to address issues of critical importance to programmers in this proceeding. The empirical data and expert analyses submitted by commenters clearly establish that the drastic revisions to the leased access rules proposed by the Commission will decrease programming diversity and result in harm to cable operators, programmers, and subscribers.

Preliminary Statement

Other than "applauding" the Commission for its leased access proposal and seeking a grab-bag of preferences and additional subsidies, leased access advocates have offered virtually no substantive data or analysis to support their claims. They assert that present leased access rates are "too high" but offer no explanation or comparison with other media outlets. They request specific de minimis per-subscriber rates which they find "affordable" without regard to the cost or value to cable operators of leased access channels. They jubilantly endorse a formula which yields "free" leased access to them because other cable programmers, operators, and subscribers are paying for it. Notwithstanding the diversity of programming presently available, non-profit entities and low-power television stations claim special entitlement to set-asides and reduced rate preferences.

In contrast, hard data -- from subscriber surveys, industry experts, and sworn declarations and affidavits -- conclusively establish that the Commission's proposals are fundamentally flawed. Notwithstanding the Commission's best intentions, its proposed formula does subsidize leased access rates which put cable programmers, such as Encore, at a serious competitive disadvantage in maintaining, much less expanding, cable carriage. Likewise, mandatory basic or tiered carriage for leased access channels is neither authorized by the statute nor necessary to provide a "genuine outlet" for leased access programming. Again, the Commission's proposal would go too far and unfairly disadvantage other programmers.

There can be no doubt, based on the record in this proceeding, that subsidized leased access will require cable operators to delete numerous existing programming services. Contrary to the claims of the leased access advocates, a universal leased access subsidy -- causing immediate and complete utilization of leased access set-asides -- is not a risk which Encore or any other programmer could reasonably have anticipated. Consequently, in order to avoid widespread subscriber dissatisfaction and anger, as documented by the subscriber surveys in the record, and potentially devastating injury to programming diversity, the Commission must establish reasonable and practicable transition rules if it revises the existing leased access rules substantially.[1]

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[1] The Commission should not rush to revise its rules without an adequate basis in the record or ignore the need for a transition period because of the thinly-veiled litigation threats of a few leased access advocates. See Comments of ValueVision International, Inc. ("ValueVision") at 16 n.27. As a number of cable programmers observed in their comments,

A. The Commission's Proposal Grossly Understates The Value Of Leased Access Channels.

As Encore concluded in its initial comments, the Commission's proposed formula would result in a leased access charge of little or nothing for most programming services carried on regulated tiers. The comments in this proceeding indisputably confirm that conclusion. For example, Tele-Communications, Inc. ("TCI") applied the Commission's formula in cable systems serving Chicago, Denver, Houston, Seattle, Tulsa, and Washington, D.C. based on the channels to be deleted in those systems. TCI Comments at 8-9. The resulting leased access channel rate ranged from a negative $.03 to negative $.10 per subscriber per channel. Id. at 14-15. TCI's findings, which are consistent with the estimates of other cable operators and independent experts, confirm that the Commission's proposal is fundamentally flawed.

This counter-intuitive result -- that leased access should be free for the lessee -- underscores the critical importance of including some measure of a channel's impact on subscriber demand in calculating the value of channel capacity. Time and time again, cable operators stressed the importance of carefully crafting an appropriate mix of well-known cable programming services and niche channels to attract the maximum number of subscribers:

> Most customers are attracted to cable, at least initially, by the availability of the large, successful, well-known cable networks. Once they become cable customers, though, many people find that there are one or more "niche" channels that also interest them, and the time they spend viewing those channels grows. And, as information about those niche channels spreads (through advertising or word-of-mouth), some customers come to cable to be able to watch the niche

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the Commission's current proposal raises serious issues under the First and Fifth Amendments to the Constitution. Comments of Outdoor Life Network, Speedvision Network, The Golf Channel, and BET on Jazz ("Outdoor Life, et al.") at 28-30; Comments of Cable Programming Coalition of A&E Television Networks, The Courtroom Television Network, NBC Cable and Ovation ("Coalition") at 40-53.

> channels. Overall, a cable system will be successful only if enough customers [are] attracted by all of these means to allow the cable operator to cover the large fixed costs of running the cable system.

Affidavit of Robert A. Stengel ("Stengel Aff."), annexed as Attachment 1 to Comments of Continental Cablevision, Inc. ("Continental"), at ¶11; see Stanley M. Besen & E. Jane Murdoch, "The Impact of the FCC's Leased Access Proposal on Cable Television Program Services" ("Impact of FCC's Leased Access Proposal"), annexed to Joint Comments of Turner Broadcasting System, Inc., News Corporation, Ltd., and C-SPAN, at 3-5.

Indeed, Mr. Stengel expressly acknowledged Encore's value in expanding premium subscribership by appealing to "never pays" and "former pays:"

> Similarly, a channel such as Encore (family-oriented movies) may reclaim audiences who have disconnected or downgraded their cable service because of objections to the content of other channels.

Stengel Aff. at ¶24. Similarly, the market research annexed as Exhibit 1 to the Comments of US West confirms that "movies from the 30's to the 80's" were the third most influential category of programming in subscribers' "decision to subscribe to cable" with 49 percent of subscribers identifying such movie programming. Encore's programming focuses on movies released during the 60's, 70's and 80's.

Data from multiple subscriber surveys confirm that the widespread deletion of programming caused by subsidized leased access pricing would result in nearly universal subscriber dissatisfaction and significant losses of subscribership.[2] For example, Talmey-Drake

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[2] These survey results are consistent with the subscriber behavior expected by expert industry analysts:

> Currently, subscribers pay a fee to acquire a specified package of programming. The Commission appears to believe that the same number of subscribers would be willing to pay the same amount for a different package of programming.

Research & Strategy, Inc. reached the following conclusions based on its survey of 908 subscribers in three cable systems:

- "[E]xactly one-quarter of respondents say they would *definitely* cancel their cable service if these regulations were to take effect."
- "Over three-quarters of respondents would be inclined to switch their cable service from their current company to a competitor, if that competitor were not required to lease out channels."
- "[O]ver half of respondents said the value of their cable service would be *very* substantially lowered if these channels were dropped."
- "An overwhelming 81% say they would be *very* or *pretty* angry if the channels indicated were to be dropped."
- "In all three systems, an astounding three-quarters or more of all subscribers say they would definitely or probably switch their cable TV service to a competitor, were the opportunity available to them."

See "Leased Access Programming Issues Survey," annexed as Attachment G to TCI Comments, at 1-5 (emphasis in original). A survey of subscribers in Continental's Broward County, Florida cable system yielded strikingly similar results -- 22 percent of cable subscribers would

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> Actual experience does not support the assumption that there will be the same number of subscribers and that subscribers would be willing to pay the same amount for leased access programs as for the existing programming....[I]f this were the case then cable operators would be eager to replace an existing cable network (and save the associated licensing fee) with a leased access channel (and obtain some positive payment) while maintaining the same level of subscriber revenues. Since there will be a reduction in subscriber revenues with leased access programming, the operator will no longer be covering all of the operating costs included in the Commission's proposed cost formula.

"An Analysis of the Federal Communications Commission's Maximum Reasonable Leased Commercial Access Rate," annexed as Attachment A to Comments of National Cable Television Association, Inc. ("NCTA"), at 12.

discontinue service in the event of leased access deletions.[3] See "The Research Network Survey," annexed as Attachment 2 to Continental Comments, at 2.

These projected subscriber losses would have a significant adverse impact on revenues, which must be reflected in the value of channel capacity.[4] For example, a 10 percent loss of business in Time Warner Cable's Tampa Bay system, which is modest in view of the above subscriber survey results, would result in a loss of "approximately 50 cents per leased access channel per subscriber." A. Daniel Kelley, "An Economic Analysis of Commercial Leased Access Pricing," annexed to Comments of Time Warner Cable, at 20. Based on his expert analysis, Mr. Kelley concludes that "[c]osts of this nature must be factored into any commercial leased access pricing analysis."[5] Id. The estimated losses on the average Continental system were even greater. A loss of only 1 percent of a typical Continental system's

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[3] In response to Survey Question No. 3, 45.1 percent of the subscribers responded that the replacement of channels would cause changes in cable subscription. Of those subscribers, 49.3 percent responded to Survey Question No. 3A that they would "discontinue cable service." Thus, 22 percent of the respondents (45.1% x 49.3%) would discontinue cable service.

[4] Mandatory carriage of leased access programming on basic or the most widely-distributed cable programming service tier ("CPST") would further understate the value of leased access capacity and exacerbate the disruptive effect of subsidized leased access. As Encore suggested in its original comments at 6, a "leased access tier" would provide a "genuine outlet" while mitigating the disruption to cable operator tiering decisions. See Comments of ESPN, Inc. at 9-10. Of course, as a CPST, such tier would be subject to the buy-through prohibition in 47 C.F.R. §76.921.

[5] Programmers suggest other proxies for measuring the value of channel capacity in order to reflect the impact of programming services on subscribership. For example, ESPN suggests that the Commission's analysis should reflect the millions of dollars invested in "programming, technology, image advertising, customer relations, and other marketing-related endeavors to 'earn' and maintain carriage...." ESPN Comments at 4. Similarly, Discovery Communications, Inc. ("Discovery") points to the "resources expended on attracting and keeping cable viewers" as an indicator of value. Discovery Comments at 7.

basic subscribers corresponds to a monthly loss of roughly $.21 per subscriber. Continental Comments at 11.

Cable operators also confirmed that they would pursue the "LIFO" or "last-in, first-out" policy anticipated by Encore in deleting programming services to accommodate subsidized leased access demand. For example. Mr. Stengel explains that, "[w]here new capacity is not available. the only sensible choice would be to displace the most recently launched, least penetrated channels." Stengel Aff. at ¶42. Because these channels have not had a sufficient opportunity to build subscribership and viewership through extended promotion, they have not reached their full revenue-generating potential. See Encore Comments at 3; Continental Comments at 17-18 ("[a] new channel will only prove its value over the long term"). Thus, the Commission's channel-by-channel valuation approach, which is limited to averaging the lost revenues directly associated with such channels, further understates the value of channel capacity. Consistent with Encore's observations. commenters urged the Commission to measure the value of channel capacity across all channels or, at the very least, tiers or "neighborhoods" of channels. See Discovery Comments at 10-11: NCTA Comments at 21-24; Comments of Cox Communications, Inc. at 9-11.

To the extent that commenters have introduced comparative data on the value of channel capacity, those data suggest that the Commission's current "highest implicit fee" structure may understate the value of channel capacity. See "Impact of FCC's Leased Access Proposal" at 14 n.19 ("we believe that the Commission's current formula results in access fees that are significantly lower than the true maximum implicit fee"). Thus, a survey of the rates for half-hour blocks in non-prime time periods of commercial broadcast stations in the Washington, D.C. Designated Market Area yielded monthly per-viewer rates for a "channel" of between $.76

and $5.25. Affidavit of Cathleen A. Schultz, annexed as Attachment 5 to Continental Comments, at ¶7. Based on its marketplace experience, Access Television Network, which sells "remnant time" to infomercial producers and advertisers, concludes that, "[e]ven under the implicit fee formula, proration resulted in part-time rates that were set well below market rates for advertising on cable systems." Comments of Access Television Network at 7.

In short, the record in this proceeding demonstrates that the Commission's proposed valuation methodology does not fairly reflect the value of leased access and yields subsidized leased access rates. Contrary to the unsupported claims that leased access rates are "too high," the empirical data suggest that the Commission's existing highest implicit fee formula, particularly when prorated into minimal time segments, may understate the value of leased access capacity.

B. If The Commission Substantially Revises Its Leased Access Rules, It Should Adopt Transition Rules To Minimize The Adverse Impact On Other Programmers And Subscribers.

Fully-subsidized leased access rates would result in artificially-expanded demand for leased access. The comments in this proceeding conclusively establish that cable systems have little unutilized channel capacity so that increased leased access demand will require the widespread deletion of numerous existing programming services in order to accommodate increased leased access. Neither cable operators nor programmers could have anticipated and planned for such government subsidized demand for leased access and the consequent deletion of existing programming services. Although clearly no solution to the problem, the Commission should adopt workable and equitable transition rules to mitigate the resulting disruption and injury to programmers and subscribers. However, reconsideration of the fundamental premises of the Commission's proposal remains the only real answer.

1. Flexible Deletion Designations.

Several programmers correctly note that the Commission's proposal to require cable operators to prepare a list of channels to be deleted for leased access "would create undue alarm with viewers, third party programmers, investors and advertisers, causing a decrease in revenue and support...." Coalition Comments at 57; see ESPN Comments at 8. Of course, if the Commission measures the opportunity cost of leased access across all channels or categories or tiers of channels, the list of channels to be deleted would be unnecessary.

If the Commission maintains the requirement to list services to be deleted, cable operators should be permitted to revise and update such list without limitation. This will enable designated programmers to negotiate for continued carriage. See Encore Comments at 7. In no event should the Commission remove the cable operators' editorial control over the channels to be deleted, as urged by a number of leased access advocates, to prevent the remote possibility of somehow "gaming" the rules. See Comments of Center for Media Education, Alliance for Community Media, Association of Independent Video and Filmmakers, Consumer Federation of America, National Association of Artists' Organizations, United States Catholic Conference at 10-11; ValueVision Comments at 4-5.

2. Implementation Transition Period.

As noted in Encore's comments at 7, cable programmers must incur programming licensing commitments and costs years in advance. See Comments of The Travel Channel at 18. Consequently, if the Commission were to overhaul the leased access rules to increase leased access demand and usage, programmers would have to revise their plans and budgets to reflect decreased subscribership and carriage opportunities. See ESPN Comments at 6-7; Comments of Lifetime Television ("Lifetime") at 5-6. Whether the Commission adopts a multi-year transition period as suggested by Encore, a "grandfathering" approach for existing services (see ESPN Comments at 7; Coalition Comments at 58), a bifurcated rate formula for vacant channels versus channels requiring deletions (see ESPN Comments at 7), or some other transition alternative or combination of alternatives, the Commission must take action to prevent massive disruption to subscribers and programmers and significant decreases in programming diversity. See Outdoor Life, et al. Comments at 37-38; Lifetime Comments at 7.

3. Minimizing Deletions For Part-Time Carriage.

The Commission should not require cable operators to delete existing programming services in order to accommodate part-time leased access carriage. Clearly, the deletion of a full-time programming service for part-time leased access decreases diversity and disserves the interests of subscribers. Coalition Comments at 59-60; Outdoor Life, et al. Comments at 30-33; TCI Comments at 33-34.

Conclusion

The record plainly establishes that the Commission's proposed valuation methodology is fundamentally flawed and yields a subsidized leased access rate which is "free" to the lessee. By ignoring the impact of programming services on subscriber demand and focusing solely on the current revenue-generating potential of newly-added programming services, the Commission's approach necessarily understates the value of leased access. Encore respectfully renews its request that the Commission maintain the existing highest implicit fee formula or substantially revise its proposal to incorporate a realistic measure of the value of leased access while eliminating mandatory packaging requirements and including modest transition relief. Otherwise, the Commission's attempt to increase diversity will yield the opposite result -- widespread deletions of existing programming services creating a justifiable outcry among cable subscribers, programmers and operators.

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Respectfully submitted,

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